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THESIS

INTERNAL CONTROL SYSTEMS FOR PURCHASING
TRANSACTIONS WITHIN THE FOURTH
MARINE DIVISION USING UNITS

by

Chester Arthur Riley III

December 1982

Thesis Advisor:

S. S. Liao

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Internal Control Systems for Purchasing Transactions within
the Fourth Marine Division Using Units

by

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Captain, United States Marine Corps
B.S., University of Puget Sound, 1975

Submitted in partial fulfillment of the
requirements for the degree of

MASTER OF SCIENCE IN MANAGEMENT

from the

NAVAL POSTGRADUATE SCHOOL
December 1982

ABSTRACT

This thesis presents a suggested generalized design base to be utilized by the using units of the 4th Marine Division when establishing a system of internal controls for purchasing transactions. It stresses administrative controls which help ascertain the need for a purchase instead of how a purchase is accomplished. After a presentation of the requirements for an adequate system of internal controls, suggested generalized controls were presented. A redesigned purchase request document and simplified flow-charts for the source of supply and purchasing method decision questions are the major controls given consideration. A methodology for the implementation and maintenance of the final tailored system of internal controls (developed ultimately by the Purchasing Officer of the Using Unit) has been included to assist the Purchasing Officer in accomplishing a smooth and complete transition of all personnel who participate in the purchasing process. The final recommendation was that all of the controls be implemented and then adjusted as required.

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LIST OF ABBREVIATIONS

BPA - Blanket Purchase Agreement
BSH - Blind and Severely Handicapped
CONUS - Continental United States
DIVSUP - Division Supply
DPSC - Defense Personnel and Support Center
FPI - Federal Prison Industries, Inc.
FSS - Federal Supply Schedule
GAO - General Accounting Office
GSA - General Services Administration
IAW - In accordance with
MARDIV - Marine Division
MCO - Marine Corps Order
OMB - Office of Management and Budget
PIIN - Procurement Instrument Identification Number
PO - Purchase Order
PRD - Purchase Request Document
SOP - Standard Operating Procedure
T/E - Table of Equipment
TAMCN - Table of Authorized Material Control Number
UMMIPS - Uniform Material Movement and Issue Priority System

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I. INTRODUCTION

A. BACKGROUND

The Budget and Accounting Procedures Act of 1950 requires the head of each department and agency to establish and maintain adequate systems of internal control [Ref. 1: p. 1]. The Office of Management and Budget amplified the requirements to include all levels of management in their 28 October, 1981 circular, number A-123. The reason for this resurgence is to curb fraud, waste, and abuse of Government resources, and promote operational effectiveness and efficiency through effective use of internal controls. The Marine Corps has responded to this directive through the development of MCO P7000.88, "Establishment and Maintenance of Internal Control Systems." Paragraph 3 of the order directs that "appropriate action to establish and maintain an effective internal control system in accordance with the policies, procedures, and standards set forth herein by 31 December, 1982" [Ref. 2: p. 9].

1. Accounting vs. Administrative Controls

The vernacular use of the term "Internal Control" has produced considerable speculation as to its precise

meaning. In reality, the only precise meaning it will have is the one ultimately defined by its user for his own purposes. To this end, the Comptroller General of the United States has defined the meaning of internal controls in the Standards for Audit of Governmental Organizations, Programs, Activities, and Functions, which is as follows:

Internal controls include the plan of organization and all the coordinate methods and measures adopted to safeguard assets; check the accuracy and reliability of accounting data; promote operational efficiency and economy; and encourage adherence to managerial policies, practices, and procedures [Ref. 3: pp. 53-54].

Marine Corps Order (MCO) P7000.88 has expanded upon this definition to include the American Institute of Certified Public Accountant's originated characterization of controls as being accounting or administrative. The reason for this characterization is to categorize the basic function of a particular control. Whereas accounting controls deal with proper procedures involved with the acquisition, safeguarding, and reporting of assets; administrative controls deal with the proper procedures that relate to the decision processes leading to management's authorization of transactions and disposition of assets. These generalizations are not an attempt to delineate controls into two distinct and definitive categories, but rather to highlight the two basic and overlapping types of controls to help dispel the traditional notion that internal controls are strictly for accounting and financial purposes. [Ref. 4: p. 248]

The importance of including guidelines for management's decision-making process (administrative controls) along with the traditional accounting controls can be illustrated by a well-known example of fraud in the Federal Government.

In 1977, a low level employee was charged with embezzling \$800,000.00 from the Department of Transportation. His responsibility was the preparation of public vouchers which listed names, addresses, and amounts owed individuals and contractors. He would then forward the vouchers to the Certifying Officer who would verify the authenticity and correctness. Then, the vouchers were submitted to the Department of the Treasury where checks were prepared and mailed to those appearing on the vouchers. The employee knew that the Certifying Officer did not closely check the vouchers before signing and that he did not require mandatory markings preventing additional entries. Apparently he simply added his own name to the vouchers, sometimes before signature and sometimes afterwards. His embezzlement might not have been detected if an alert bank employee had not questioned federal checks ranging from \$55,000.00 to \$315,000.00 being deposited in his personal account [Ref. 5: P. 3-4].

If the accounting control of marking the vouchers so as to prevent any additional entries was closely followed, the lackadaisical authorization by the Certifying Officer would have made the embezzlement still feasible. Conversely, close scrutiny of the vouchers by the Certifying Officer would not have detected postings made after his signature. Avoiding fraud in this case was dependent upon adherence to both accounting and administrative controls.

The combining of the traditional accounting controls with controls coordinating authorization decisions with operational effectiveness and efficiency forms an interlocking system of internal controls. When applied with full management support, this system will substantially minimize the potential for misuse of government resources.

2. The Impact of Inadequate Systems of Internal Control

Recent audit findings have shown general lack of, or weaknesses in, systems of internal controls in the financial management system among Federal Procurement Agencies. One of the most notable reports was The Relationship between Internal Controls and Fraud, Waste, and Abuse, submitted on August 28, 1980, by the General Accounting Office (GAO). In their review of eleven Federal Agency Fiscal Offices, they found widespread, similiar, and prevalent financial control weaknesses. The GAO believed that these weaknesses exist throughout the Government since the operations reviewed represented a cross section of the major activities carried out by the Federal Government. The report ended with some generalized conclusions, which may be summarized as follows:

1. In many cases, the agencies' own procedure manuals or regulations (implementing standards published by Treasury and GAO) specify the controls needed, but the controls had not been incorporated into fiscal offices' day-to-day operations.

2. Experience has shown that constant vigilance by management is necessary to insure continued effective operation of internal controls.
3. Direct costs due to weaknesses in internal controls are not individually large, but are significant when projected Government-wide.
4. Weaknesses in systems of internal controls result in inaccurate accounting records, which produce erroneous financial statements and financial decisions.
5. Failure to control financial operations reduces funds otherwise available for operating agency programs.
6. Stronger measures are needed to bring about lasting improvements to the systems of internal controls.

The report recommended that the Congress enact legislation to place greater responsibility upon the heads of federal agencies for the soundness of their organizations' system of internal controls. [Ref. 6: pp. 53-54]

Results such as these have created a resurgence of emphasis on systems of internal controls. The Office of Management and Budget (OMB) has reiterated and expounded upon the Budget and Accounting Procedures Act of 1950 in their OMB Circular Number A-123, dated 28 October, 1981. Directives such as the aforementioned have cumulated, resulting in MCO P7000.88, which directs the establishment and maintenance of adequate internal control systems in the Marine Corps by 31 December, 1982.

B. PROBLEM

Unlike the rest of the Marine Corps (which has centralized Contracting/Purchasing Offices), the Fourth Marine Division Using Units are normally isolated from procurement support, necessitating the use of independent purchasing from within the unit. In most cases, the personnel charged with the purchasing duties have little (if any) prior familiarity with the proper procedures. This is supported by the last three summation analysis reports for inspections conducted by the 4th Marine Division Supply Inspection Unit during the period of 1 November, 1980 through 15 April, 1982. All three of these summation reports stipulated that the "geographic dispersion of subordinate units and lack of close proximity to command and support facilities are considered the major contributing factors to noted discrepancies" [Ref. 7: p. 3]; [Ref. 8: p. 4]; [Ref. 9: p. 5]. Though the expertise needed for unusual problems is available through a phone call, day-to-day purchasing transactions must be performed at the using unit level.

MCO P7000.88 (effective 31 December, 1982) requires that an adequate system of internal controls be implemented by management to help curb fraud, waste and abuse [Ref. 2: p. 9]. This requirement has created an arduous task for the Purchasing Officer of the Using Unit, since he also normally

has little prior experience with proper purchasing procedures.

C. RESEARCH QUESTIONS

Though specific guidance is given as to the appropriate accounting procedures that should be utilized for effective internal control, little guidance is given on the administrative procedures or the development of administrative controls. Additionally, if the Purchasing Officer has little prior purchasing experience, even the accounting procedures can become cumbersome. If the Purchasing Officer is to be effective in the completion of the directive to establish and maintain an adequate system of internal controls, he must have a well developed concept of the necessary requirements.

The following questions will have a direct effect on the Purchasing Officer's ability to understand the requirements needed for an adequate system of internal controls for his Using Unit:

1. What is needed prior to control development?
2. What are the mandatory control requirements?
3. Where should control emphasis be placed?
4. What restrictions should be placed on control development?

5. What is the purpose of administrative controls?
6. How is administrative control accomplished?
7. How should the final system of internal controls be implemented?
8. How is the system of internal controls effectively maintained?

D. PURPOSE AND SCOPE OF THESIS

This thesis will attempt to establish a generalized foundation to facilitate the formalizing of a system of internal controls for day-to-day operational purchasing transactions executed by the Using Units of the Fourth Marine Division.

The Marine Corps Purchasing Procedures Manual (MCO P4200.15E) is highly informative and detailed with respect to proper accounting procedures and offers some relief to the difficult purchasing process. This thesis will concentrate on administrative controls, which focus on ascertaining the need for a purchase instead of how the purchase is accomplished. This will facilitate the proper utilization of funds through more complete and accurate criteria for purchase authorization. Guidance will also be provided to help focus on the applicable accounting procedures and methods that are promulgated in MCO P4200.15E.

E. METHODOLOGY

An extensive review of current literature on the requirements for an effective system of internal controls was conducted. The literature serves as the basis for evaluating the strength and weakness of the 4th Marine Division's current internal control practice. In order to update the expertise that was once held by this author three years ago as the Officer-in-Charge of the 4th Marine Division Supply Inspection Unit, phone conversations were conducted with the Marine Officer currently holding that same billet. Relevant documents supplied by the current Officer-in-Charge were examined. During the writing of the thesis, points of potential ambiguity were discussed with the Officer-in-Charge of the Inspection Unit to confirm or correct the author's perception of the intent of the applicable order or manual.

The current and pertinent manuals and orders were obtained via the publication section at the Marine Corps Logistics and Support Base located at Albany, Georgia.

Chapter II presents the generalized requirements for an adequate system of internal controls by offering an approach to the heuristics of development, development requirements, techniques, and the implementation and maintenance requirements that can be used by the Purchasing Officer. Chapter

III is a suggested generalized design base that should be utilized when the Purchasing Officer is tailoring a system of internal controls for his using unit. Chapter IV offers an explanation to the potential problems of implementing and maintaining a system of internal controls. It also suggests a methodology that can be used to deal with these potential problems by shaping the implementation and maintenance. The final chapter will summarize this thesis and present concluding remarks.

II. REQUIREMENTS FOR AN ADEQUATE SYSTEM OF INTERNAL CONTROLS

A. CRITERIA FOR SYSTEM DEVELOPMENT

The heuristics involved in developing an "optimal" system of internal controls far exceed the current capability of management science. Because of the divergence and subjectivity of the factors that influence controls, management must use its best estimate as to whether a certain control will or will not be incorporated into the ultimate system. The best that management can do currently is to investigate the prime criteria that impact upon the heuristics of control development.

1. Materiality

The process of developing internal controls is aimed to arrive at a satisfactory level of assurance regarding the performance of the organization. However, it is not economical or necessary to arrive at 100% assurance. Consequently, the limited time a manager can devote to obtaining a desired level of assurance must be spent on matters of importance and substance. The term used to describe this segregation of what is important and what is trivia is materiality. [Ref. 10: P. 330]

"When generally expressed, it is a simple concept to understand. However, application of the concept is difficult due to the relativity of the term" [Ref. 10: P. 331]. The environment (both internal and external to the organization), the objectives of the organization, and the level of hierarchy concerned with the application, are all pertinent factors in the determination of material weaknesses. The manager of a public affairs department could possibly have a budget in excess of a million dollars and he is highly concerned as to its utilization. A senior executive of the same company sees it as less than 1% of the organization's operating budget and deems it as inconsequential compared to production or personnel costs.

There is no way currently known to generalize the application of the term materiality. However, managers in specific positions have experienced "events that show the wisdom (or error) of the judgement that was made and these cases then become the building blocks of a more complete, improved, and integrated materiality concept" [Ref. 10: P. 346]. With experience as the key and judgement as the mode of quantifying the experience, guides can be expressed for specific management positions through some sort of policy guidance that can be disseminated to a larger interest group and turnover files for the next individual that will fill the position.

Whether the manager has experience, has policy guidance from the previous manager, has guidance from higher authority, or is just left holding the bag, he must draw the line for materiality.

A well-developed concept of materiality is required when evaluating weaknesses in a process being scrutinized, otherwise the manager will be mixing the relevant information with inconsequential data.

2. Risk Assessment

Risk assessment is an essential ingredient to the materiality process. It consists of two major factors -- the magnitude and frequency of occurrence of the risk. The "magnitude" is basically the estimated amount of potential loss from each occurrence. The "frequency of occurrence" is self-defining. Together, the two factors will express an "exposure" rate for some set time frame. [Ref. 2: encl. 2, p. 2] Without looking at both aspects of the exposure rate, one would be evaluating control development upon isolated incidents vice the total effect.

Much like materiality, risk assessment is a judgment call. Whether one uses past experiences as guides or pulls estimates from the air, exposure rates must be given consideration in the development of internal controls.

3. Cost-effectiveness Considerations

Once the material weaknesses have been identified, the manager must decide the most cost-effective alternative to employ. Since the cost of controls can be estimated with a fair degree of accuracy, it is basically an exercise in devising viable alternatives to solve the problem. However, the effectiveness of each alternative control could again be based upon a manager's speculation. A manager must combine the cost and effectiveness and apply it to the weakness in a way that best supports the objectives. The end results should represent a step closer to the desired performance.

A cost-benefit analysis is a good approach in the attempt to optimize the projected results of a control. By estimating the benefit that is derived from each proposed control and deducting the control cost, you are able to compare all the controls since they are all based upon the same scale.

By analyzing the interaction between the processes, people and environment in the form of attributes of performance, the current state of the organization is inferred. The comparison of the organization, the objectives, and the desired results will lay the foundation in the developmental and ultimate decision criteria. General questions should be included while deciding as to the adequacy of any one

control. Some of the more pertinent questions are as follows:

1. Is the control compatible with the organization, people, procedures, and processes?
2. Does the control attack the potential cause and not the effect?
3. Does the control reduce the potential of and/or flag a signal at an occurrence of an error or irregularity?
4. Is the control cost-effective?

The accumulation of acceptable controls will form the system which again must be evaluated, but as a whole, with questions such as the following:

1. Can the data resulting from the system (whether feedback on the system or results of the transactions) be readily evaluated into useful and understandable information by the end users?
2. Is the information adequate to base needed decisions upon?
3. Does the information fulfill both mandatory and desired requirements?
4. Does the system address both short-range and long-range requirements?
5. Does the system help maximize the utilization of resources to the fullest extent possible, while minimizing the cost?

After implementation, the accepted system of internal controls will be constantly revised using the same process to improve weaknesses discovered and mandatory changes from higher headquarters. The ultimate results should be what management has determined as being reasonable assurance that the objectives of the system are being accomplished.

B. REQUIREMENTS FOR AN ADEQUATE SYSTEM

1. Documentation

Written records are required during all stages of the system of internal controls. Documentation of the objectives develop the basis and reason for the system of internal controls. Recording of the system allows for the standardization of the controls, which eases the implementation and evaluation of the system. Documentation is also required to promulgate any and all changes required from weaknesses discovered during the review process. Finally, documentation of compliance increases the confidence level of actual utilization of the system, and alludes to, if not designates, the individual(s) responsible for errors and irregularities. [Ref. 2: p. 6]

2. Clearly Defined Control Objectives

Focusing the development of controls is established by the documentation of objectives. Formulating objectives depends upon the organization's policy statement, any identifiable peculiarities of the organization, weaknesses discovered from past experiences, and desirable specific purposes. The results of controls based upon these objectives should produce any mandatory information for management and higher headquarters, and achieve the desired level of performance in the fulfillment of all duties. [Ref. 11: p. 124]

C. INTERNAL CONTROL TECHNIQUES

When developing the internal control(s) for a particular objective, there are two basic techniques that can be employed, which are as follows:

1. Detective Controls

These controls are primarily used to discover the occurrence of errors and irregularities after they occur. Although these controls are necessary to help alert management of ineffective preventative controls on a timely basis, they deter individuals from making errors and irregularities only to the extent that they feel detection will be made.

This indirectly contributes to prevention, but lacks the reinforcement of the other technique.

2. Preventative Controls

This technique directly deters individuals from making errors and irregularities. Unlike detective controls, these controls are designed so as to reduce the opportunity to commit errors and conceal irregularities from the day-to-day operations. Additionally, confirmation of a preventative control might detect noncompliance, changing the control to a dual-purpose device. [Ref. 5: p. 49]

The development of preventative controls is crucial to an adequate system of internal controls. Along with proper procedural methods and measures, special emphasis should be placed upon the following preventative controls:

a. Separation of Duties

Proper development of this key requirement will reduce the probability of intentional irregularities, and unintentional errors by the cross-checking of pertinent information by other individuals within the transaction flow. Duties such as authorizing, making payments, auditing, issuing and receiving, etc., should be considered when deciding the appropriate duties to separate. [Ref. 2: p. 6]

b. Access to Resources

By authorizing a limited number of personnel access to resources, responsibility of errors and irregularities is also narrowed. The more pilferable the resource, the more restrictive the control should be. In cases such as cash, only one person should be responsible so there is no doubt who is responsible for any shortages. Indirect access, such as documents authorizing the use or disposition of resources, should be limited to those directly involved in the transaction process. [Ref. 2: p. 7]

c. Authorization

Management should take great care if and when they should ever decide to relinquish any of their decision-making authority since it is the best control management has on the status of day-to-day operations. Authorization from someone not completely indoctrinated in both the short-run and long-run needs of the organization can at the very least reduce the potential for optimal utilization of resources. Any operation that is not in some way authorized by management is an open door for fraud, waste, and abuse.

D. IMPLEMENTATION AND MAINTENANCE

1. Supervision

Management's participation will greatly determine the degree to which the system of internal controls will be actively implemented. Continuous supervision will help assure that approved procedures are followed. A major portion of this supervision should be the frequent internal review of the system of internal controls to determine the effectiveness of the procedures and results, and to continuously update the system. [Ref. 2: p. 7] This process of internal review would be accomplished using the same format as explained in this chapter. It must always be remembered that a system of internal controls is "management's responsibility" [Ref. 3: p. 36].

2. Competent Personnel

Reasonable care should be taken to assure that key personnel have high standards of integrity, and are competent via education, training, and/or experience to accurately accomplish their assigned duties. Efforts should be made to retain this competence through continual education and training in order to keep abreast of current trends and changes. [Ref. 2: p. 7]

3. Proper Execution and Recording of Transactions

Transactions shall be recorded as executed, when executed, and in accordance with the procedural methods and measures as specified by the system of internal controls to effect timely and accurate results. Spot checks should be accomplished during internal review to maintain a high degree of compliance. [Ref. 2: p. 7]

4. External Review

To afford an objective evaluation of the system of internal controls, third parties should be utilized when possible. External inspectors evaluate controls based upon the actual effect of the controls and not the stated or assumed effect. Unknown deficiencies and potential streamlining of the system of internal controls is also brought in by third parties. However, it should be realized that external inspectors cannot understand the intent and impact of the organization and its objectives as well as personnel participating in the day-to-day operations.

III. GENERALIZED DESIGN BASE FOR THE SYSTEM OF INTERNAL CONTROLS

The following generalized design base has been developed to facilitate the Purchasing Officer's task of tailoring a system of internal controls for his unit's day-to-day purchasing operations. The aspect of "day-to-day" should be stressed, since the intent is to identify the processing and procedures required on a recurring and continuous basis. All requirements that are accomplished only once (or at least seldom) will not be included as part of this design. (However, one should note that the frequency of performance alone is not an indication of the importance of a requirement and applicable controls should be developed for all aspects of purchasing that warrant their development.)

A. PURCHASING OBJECTIVES

Standardizing objectives for all potential contingencies that could confront the using units of the 4th MARDIV is impossible due to the variety of their missions and locations. However, some generalized objectives are applicable for small purchase functions accomplished by all the using units, such as those that follows:

1. Access to purchasing documents and resources should be controlled.
2. Sufficient funds should be available to cover the obligation of the purchase.
3. The type of goods or services, method obtained, quantities, prices, source, and when to buy them should be properly authorized.
4. All adjustments not covered by the initial purchase submission should be properly authorized.
5. Purchases should be acquired through the appropriate source.
6. Purchases should be properly classified into the appropriate method.
7. Purchases should be processed on a timely and appropriate basis.
8. Access to receiving should be limited to those individuals concerned.
9. Goods and services received should be accounted for properly and on a timely basis. [Ref. 12: pp. 20]

MCO P4200.15E spells out the exact accounting controls mandatory to accomplish small purchases. But accounting controls are not enough to ensure proper utilization of the using unit's resources.

The Purchasing Officer's function is much more than an authorizing signature and verification of properly processed

purchases. Since it is seldom that approved funding is sufficient for all needs of a unit, his decisions of what to buy and when to buy have a direct influence on the effectiveness and efficiency of unit. To complicate matters, requests are staggered over the entire fiscal year and decisions are made not always knowing the future requirements. Without adequate information and evaluation, less than desirable results could be produced. Though evaluation depends upon the Purchasing Officer's judgement, properly constructed administrative controls can do much to facilitate that judgemental process by acquiring useful decision information. Examples of useful administrative control information are as follows:

1. What is the impact of the need on unit effectiveness?
2. What is the impact of the need on unit efficiency?
3. What is the impact without the need?
4. Are there alternatives to the need?
5. Is the need mandatory?
6. Is the need cost-beneficial?
7. Can the need be delayed? If so, how long?
8. How does the need compare to other actual and projected needs?

9. What is the effect of the need on the status of funds if approved?

The end result should be the best attempt possible at achieving the ultimate objective of "the timely and proper utilization of funds when accomplishing purchases."

B. ASSIGNMENT OF PURCHASING DUTIES

Great care should be taken when assigning individuals entrusted with controlling funds and/or resources of the Marine Corps. The individuals chosen should have demonstrated high moral standards and integrity. Anything less could increase the potential for compromises in the function being performed.

1. Standards of Conduct and Duty Assignments

Personnel representing the government in business dealings with industry are in positions of grave responsibility. To encourage nothing but the highest degree of conduct, MCO P4200.15E requires that indoctrination and reindoctrination as to the Standards of Conduct be conducted every March and September. The purpose of the standards is to eliminate the potential of compromising and embarrassing both the Marine Corps and Marine Corps personnel due to actual or apparent conflict of interests. Acceptance of

gratuities, actions resulting in personal profit either directly or through financial interests, or any other actual or apparent influences which reduces strict impartiality is prohibited. Though there is no way of ensuring compliance with the above requirement, appointing individuals with no applicable outside interests or associations would at least limit the potential. [Ref. 13: Chap. 4, pp. 3-6]

2. Separation of Duties

Purchasing may be segregated into three main functions of administrative processing, authorization, and receiving the requested purchase. Separation of the duty assignment of each of the functions helps to safeguard the unit's resources. Since the delegation of authority to the Purchasing Officer is accomplished by the 4th MARDIV Commanding General and the administrative processing is normally accomplished by the supply chief, the only position left to ponder is the receiving of the requested item(s) or services.

It is suggested that the requestor of the need also be the receiver of the purchase when it is actually being physically obtained. This allows for the verification of the serviceability and suitability of the request before actual acceptance. Though confirmation is not always needed (especially if the request is commonly known or an industry

standard), many mistakes can normally be corrected prior to acceptance. However, verification as to the authenticity of receipt should be made to prevent the potential for collusion.

C. ACCESS TO RESOURCES

The mandatory detailed requirements for safeguarding the imprest fund are specified in MCO P4200.15E. Along with suitable physical security measures, it stipulates that only the individual charged with custody of the funds will have access to the funds. It is obvious that cash is highly liquid and non-traceable. However, the potential for pilferage or misuse does not stop there.

Purchase Orders could be improperly utilized if access to these forms is not controlled. Although the purchase order is negotiable only after an authorized signature, acceptance of fraudulent submissions by public sources of supply may compromise effective utilization of resources or damage the Marine Corps' standing within the community when payment is denied. Access to purchase orders should be limited to the Purchasing Officer and Administrative Processing Clerk or Chief.

Lack of accountability for purchased items can also lead to potential pilferage. Receipt of an item does not

constitute a completed transaction. Proper and timely recording of items purchased should be verified.

D. PURCHASE REQUEST DOCUMENT

The first required administrative step to purchasing is the "Purchase Request Document" (PRD). MCO P4200.15E directs the minimum information requirements on each of these documents. This information helps to establish a firm foundation for the accounting controls in the purchasing process. The minimum requirements answer the "what" and "when" of the proposed purchase, and alludes to the "where" and "how" the purchase should be accomplished. However, the information that is a major consideration in the ultimate decision on the purchase is the administrative control question of "why." This does not mean that the Purchasing Officer doesn't acquire the information prior to the decision. It does mean that the "why" is required to make a practical decision. Figure 3.1 illustrates the impact of "why" on the decision.

Though the example is exaggerated and oversimplified, it shows that though the requested need was the same, the actual need was considerably different. If further clarification (which should already known by the resquestor) was added to the PRD, there would be no need for inquiries.

Additionally, there would be documentation that would support every purchase made. (This process would also work for services.)

Three units have submitted purchase request documents to their respective Purchasing Officer. The information on each is similar and the item being requested is a refrigerator. However, the "why" is not on the request and some further information is required. The results of a simple inquiry produces the following;

1. Unit 1. The refrigerator is an authorized piece of equipment and is necessary for the fulfillment of the mission, which is food service.
2. Unit 2. The refrigerator is a local allowance item and will be used to store small batteries (and probably the soda mess) of a infantry unit.
3. Unit 3. The refrigerator is a local allowance and is needed to store film bought in bulk by a unit with a mission of photo reconnaissance.

Figure 3.1 THE IMPACT OF "WHY" ON A PURCHASE DECISION

Though this information links the operational process with the beginning of the purchasing process, what information closes purchasing back to the operational process?

The purchasing process results in some sort of physical supplies or services. The safeguarding of these results would close the purchasing process into the operational process. In short, the item(s) or services received were utilized for their intended purposes. Again, this is not

some sort of inhibiting request, it is just documentation of information that should already be known.

Figure 3.2 illustrates the proposed PRD. All mandatory entries required by MCO P4200.15E have been annotated. Further clarification of the exhibited PRD information is as follows:

1. Item/Services Description. Required entry which gives a full explanatory description of the request. Specifications of item(s) should come from the Identification List File when applicable. Otherwise, all physical and functional characteristics needed to express the minimum requirements of the request shall be fully explained. [Ref. 13: Chap. 7, p. 5]
2. Source of Need. This gives the authoritative allowance, if applicable. (The T/E TAMCN, the local allowance, component of a T/E End Item, or describes whether it is an operational, administrative, or training expendable item, are all examples of sample entries.) It should also state whether the item has been dropped from the records recently due to the completion of an investigation or due to inventory shortages. Any additional remarks that help clarify the need should be annotated.
3. Priority/Delivery Date. Required entry which specifies the UMMIPS priority and/or the required delivery date. [Ref. 13: Chap. 7, p. 5]
4. Special Shipping/Marking Instructions. Required entry specifying any special packaging, marking, or handling instructions. [Ref. 13: Chap. 7, p. 5]
5. Impact if Denied. This supports both the need and the priority specified in the aforementioned requirements. It also gives the Purchasing Officer valuable decision-making information, such as the impact on the unit's effectiveness and efficiency, compliance with mandatory requirements, and the effect on normal operational capabilities.

PURCHASE REQUEST DOCUMENT

ITEM(S) OR SERVICES DESCRIPTION: _____

SOURCE OF NEED: _____

PRIORITY/DELIVERY DATE: _____

SPECIAL SHIPPING/MARKING INSTRUCTIONS: _____

IMPACT IF DENIED: _____

REQUESTOR SIGNATURE _____ SECTION _____ DATE _____

CITATION OF FUNDS: _____

APPROPRIATION DATA: _____

ESTIMATED COST: _____

RECOMMENDED PURCHASING METHOD: _____

RECOMMENDED SOURCE: _____

PUR CHIEF SIGNATURE: _____ DATE _____

PURCHASING OFFICER SIGNATURE: _____ DATE _____

DOCUMENT NUMBER: _____

PIIN NUMBER: _____

PUR CHIEF SIGNATURE: _____ DATE _____

ITEMS (SERVICES) SUITABLE AND SERVICEABLE: _____

REQUESTOR SIGNATURE: _____ DATE _____

PLACE COMMENTS ON BACK

Figure 3.2 PURCHASE REQUEST DOCUMENT

6. Requestor Signature, Section, and Date. This specifies the who and when of the request which begins the time frame for judging the transaction timeliness.
7. Citation of Funds. Required entry that specifies the availability of the funds at the time of the request. (Purchasing is accomplished utilizing the OSMC appropriation, 2710 subhead funds.) [Ref. 13: Chap. 7, p. 5]
8. Appropriation Data. Required entry that confirms that the type of funds the amount was cited from is the type that will be used in processing an approved PRD. [Ref. 13: Chap. 7, p. 5]
9. Estimated Cost. This will facilitate the decision of the Purchasing Officer by estimating the amount of funds that will be depleted due to an approved purchase prior to approval. It will also serve as a control to help stop a potential over-obligation of funds.
10. Recommended Purchase Method. This will provide the Purchasing Officer the ability to verify the purchase method prior to the administrative work needed to accomplish a purchasing method. (This is especially useful when more than one method is available or the amount is close to a monetary limit that, if exceeded, would be inappropriate for the method chosen.)
11. Recommended Source. Required entry that allows for verification of the source of supply. Any deviations from mandatory sources should be briefly stated as to the authorized reason for circumventing the source. (Since some exceptions do not require statements explaining the reason, this entry is documentation that helps establish a better audit trail.) [Ref. 13: Chap. 7, p. 5]
12. Purchasing Chief Signature and Date. Traces the timeliness of processing the purchase request document. (Especially important on high priority requests.)

13. Purchasing Officer Signature and Date. Required entry that authenticates the authorization and gives the effective date the preparation of the actual purchase may begin. "Denied" should be annotated in the signature block for nonapproval. [Ref. 13: Chap. 7, p. 5]
14. Document and PIIN numbers. The document number is an audit control number that traces the item(s) or services purchased until properly accounted and recorded or cancelled. (Expandable supplies are properly accounted for upon receipt by requestor.) The PIIN number is similar, except it traces the actual purchase documents until completion or cancellation.
15. Purchasing Chief Signature and Date. Another verification as to the timeliness of processing the request. (The julian date on the document number should match the date of the signature.)
16. Items(s) or services received were suitable and serviceable. This verifies that the received item(s) or services fulfilled the requirements of the requestor.
17. Comments on back. This should specify peculiarities of the purchase such as the specific BPA call number, the documentation of all oral quotations, or any unusual problems encountered during the purchase processing. Additionally, any specific information that helps to establish a better audit trail (such as the general contract number for a delivery order) should be annotated on the back of the PRD.

This PRD establishes basic and sorely needed administrative controls and builds upon the accounting controls of the mandatory (MCO P4200.15E) PRD. By documenting the confirmation of the timeliness, need, benefit, and receipt of each purchase, the PRD is utilized more as a central control document than an initiating request. All major stages of

the request are acknowledged (in writing) by the individual charged with performance of that requirement. The audit trail of each purchase becomes more definitive with little additional effort, thereby reducing the potential for misuse of resources.

E. SELECTING THE SOURCE OF SUPPLY

Administrative processing of an approved PRD cannot be performed without a determination on the source of supply. Purchasing documents are determined (or limited) by the appropriate source of supply. MCO P4200.13E prescribes the extensive mandatory and suggested sources that should be utilized for purchasing.

1. Federal Supply Schedules

Federal Supply Schedules are listings of contracts established by GSA every year of selected items. These contracts have the advantage of economies of scale since they're utilized DOD wide and are the prime source of supply when applicable. Mandatory usage of FSS is stipulated for each scheduled item. However, overriding exceptions to the schedules apply under certain conditions, which are as follows:

1. Delivery Requirements. If the stated delivery period of the FSS is in excess of requirements and no relief can be supplied by the applicable contractor, another source of supply can be sought.

2. Acceptability of Similar Item(s). When specific item(s) are required and the FSS lists similar but unacceptable mandatory item(s), a statement as to the reason must be forwarded to the Commissioner of GSA for approval prior to purchase.
3. Emergency Requirements. In emergency situations, item(s) can be bought from other sources of supply. However, a statement as to what prompted the circumvention will be forwarded to the Commissioner of GSA within 15 days.
4. Purchases of \$50.00 or less. When orders are under this minimum limitation, the schedules are not mandatory and other sources of supply can be sought if more economical to process. (However GSA Stores have a minimum order requirement of \$25.00.)
5. Outside Conus. FSS apply only to the extent that the geographic area is included in the applicable contract.
6. Maximum Order Limitation. Each schedule will stipulate the maximum order quantity allowed. This type of exception should be rare since contract quantities usually are sufficient for most user's needs. It, never-the-less, is an exception for valid requirements. [Ref. 13: Chap. 5, pp. 5-18]

Close adherence to FSS is required to promote future contracts placed by GSA. Without utilization, the economies of scale principle will fall by the wayside. These contracts serve large geographical areas and though the price may be less in some areas, the overall area the contract serves will be at a price equal to or less than most local prices. For this reason, price is not a valid reason for circumventing FSS. A small savings to some units

can eventually add up to a large price loss to DOD in the form of higher contract prices in the long run.

2. General Services Administration Stores Depots

Similar to FSS, the GSA Stores Depot also uses the economies of scale principle. However, its major function for most units are the mandatory services contracts for maintenance, repair, rehabilitation, and reclamation. With only ten regional offices, the vast majority of units must utilize the commercial sources as specified in the "Guide to Source of Supply and Service." However, the Purchasing Officer should verify the applicability of the nearest regional office (MCO P4200.15E, para 0521) even if the depot has never been utilized before. [Ref. 13: Chap. 5, pp. 23-25]

Exceptions to GSA Stores usage include purchases less than \$25.00, unacceptable delivery dates, and all subsistence and medical items under DPSC cognizance. [Ref. 13: Chap. 5, p. 23]

3. FPI and BSM Made Products

All Federal Prison Industries and most Blind and Severely Handicapped-made products are available through GSA Stores. However, if purchasing directly from FPI or BSH is determined to be practical and economical by the Purchasing

Officer, it should be utilized. Once this decision has been approved, the only exception that should be applied is delivery time restrictions. [Ref. 13: Chap. 5, pp. 27-30]

4. Local Sources of Supply

The last source of supply is local purchasing. The determination of what is deemed the minimum practical and economical purchase through other sources has already been determined, thereby eliminating price as an exception. Local procurement should be used only after all alternative sources of supply have been determined to be inapplicable or inadequate.

5. Source of Supply Desk-top Procedures

Verification of the proper source of supply can become extremely difficult to implement into day-to-day operations. Figure 3.3 has been developed as a workable guide that can facilitate the verification of appropriate sources of supply compliance. The extent of utilization is dependent upon the Purchasing Officer's judgement.

It should be noted that there is a dominating exception that applies in most instances, which is the Delivery Time Requirements. No one can fully predict the needs of the future. However, trends in excessive utilization of short delivery periods should be scrutinized by the

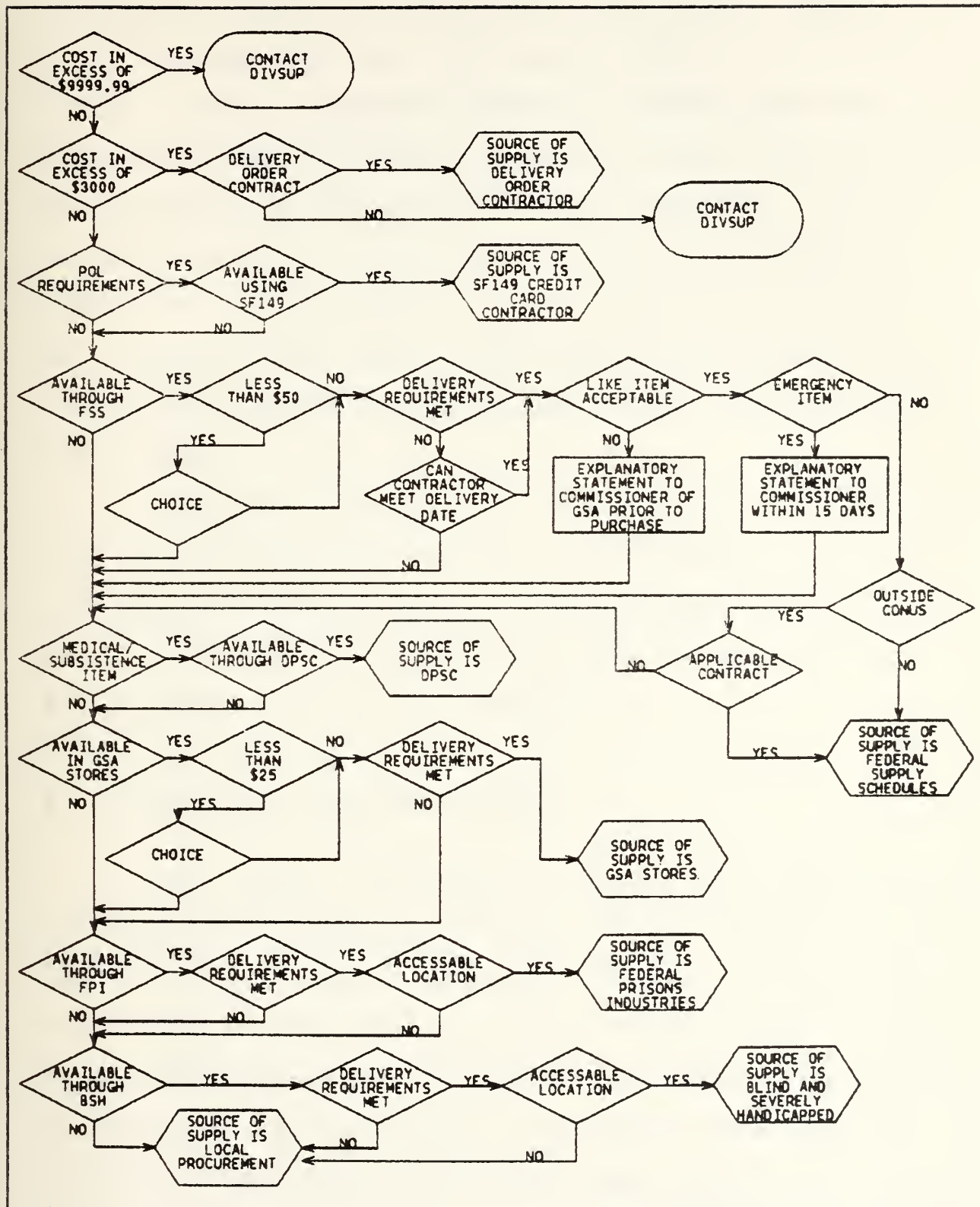


Figure 3.3 SELECTING APPROPRIATE SOURCE OF SUPPLY

Purchasing Officer in attempt to curb future usage. A little trouble-shooting could reveal poor planning at the section level, excessive losses of mission essential or important items, or even a Purchasing Clerk attempting to follow a path of least resistance by exclusive utilization of local sources. Corrective action at the source of the problem not only increases proper operational procedures, but improves the overall unit creditability when using restrictive delivery requirements or other source of supply exceptions.

Improper utilization of the sources of supply is more than a violation of Marine Corps Directives. It is an avoidable additional cost of future contracts that affect all of DOD due to the lack of being able to implement economies of scale to its fullest potential.

F. SELECTING THE PURCHASING METHOD

In many cases, the source of supply will require the utilization of a certain purchasing method. This is not the case with local sources of supply. There is considerable overlapping between a BPA, PO, and the imprest fund. A BPA is strongly suggested for filling anticipated, repetitive needs such as hardware items. The purchase order allows for written specifications and/or more than one delivery. The

imprest fund is a simple method for routine items not in excess of \$150.00. Which method should be used?

MCO P4200.15E gives mandatory usage in only certain cases. The final decision on which method should be used when overlapping occurs depends on factors such as follows:

1. Which method is mandatory? (If the purchase requires written quotations, a PO would be in order.)
2. Which local source is the most economical? (An item under an established BPA may not be the best buy within the local sources of supply.)
3. Which method is the most practical? (Time restrictions could necessitate the utilization of the imprest fund method.)
4. Which method is the most economical to process? (An example is the cheaper processing costs of the BPA over the PO method.)
5. Is the method acceptable to the local source? (An example might be the acceptance of only cash at a local source as the method of payment.)

Figure 3.4 depicts the author's interpretation of the intent of MCO P4200.15E as it applies to the total process for determining the appropriate purchasing method. This desk-top procedure is not totally mandatory, though the price limitations are structured IAW MCO P4200.15E. However, general utilization of the chart should facilitate the selecting of the appropriate method.

NOTE: ALWAYS USE THE SF149 CREDIT CARD FOR POL REQUIREMENTS IF APPLICABLE.

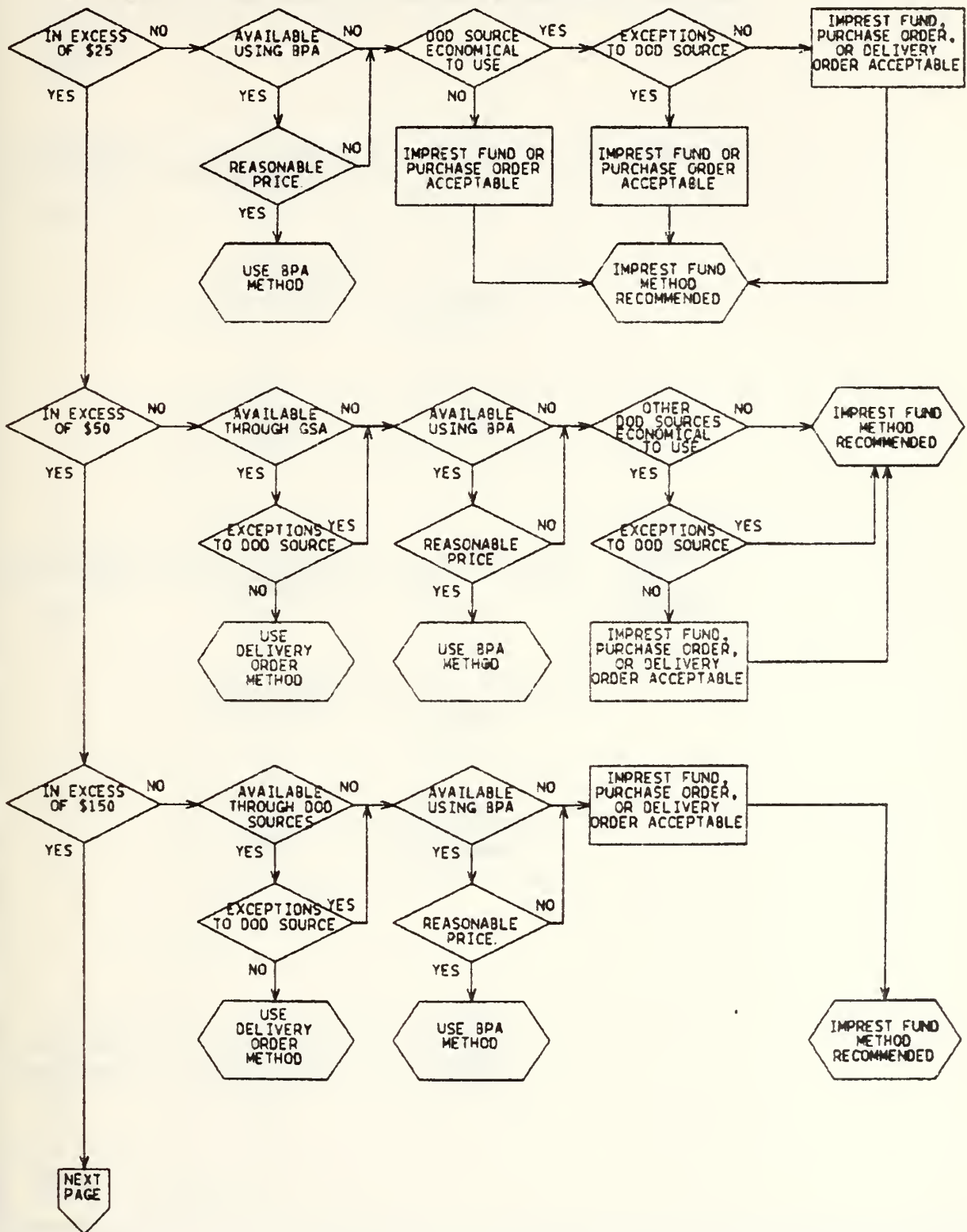


Figure 3.4 SELECTING APPROPRIATE PURCHASING METHOD

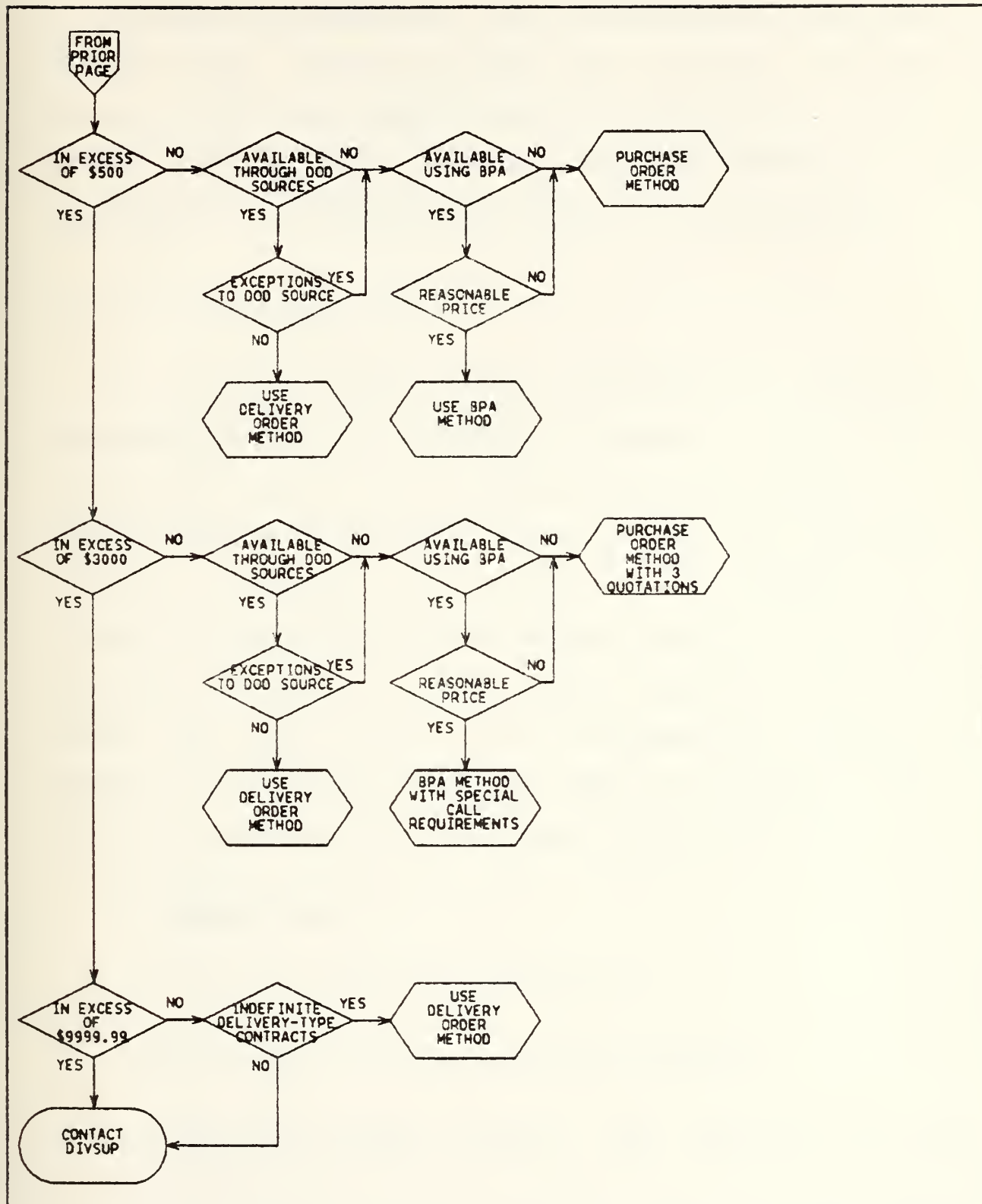


FIGURE 3.4 - CONTINUED.

It should be remembered that the purchases accomplished with the local sources of supply have a maximum limitation of only \$3000 per request unless the supplier is under a current delivery order contract with the government, as outlined in the aforementioned sources of supply section.

G. PROCESSING PURCHASES

The ultimate preparation and processing of purchasing documents is, at the very least, tedious. With all the regulations required for different purchasing methods, it is near impossible to develop a checklist that will take every possible contingency into consideration. However, the following questions should be answered along with pertinent questions stipulated in the DIVSUP Inspection Checklist during the utilization of the corresponding purchasing method. All questions following that do not have an answer of "yes" should be fully researched in MCO P4200.15E.

1. Imprest Fund

1. Is the PRD completely filled out?
2. Are the specifications relatively simple?
3. Does the purchase require one delivery and one payment?

4. Are the item(s) and/or services available within 30 days?
5. Can recurring requests be handled through the BPA method?
6. Is a subvoucher number assigned and annotated on the PRD?
7. Is an interim receipt for cash properly utilized for cash withdrawals?
8. Are receipts tendered properly annotated with the amount, date, and seller's name and position?
9. Is an SF1034 used when payment by check is required?

2. Blanket Purchase Agreements

1. Is the PRD completely filled out?
2. Do individuals authorized to make calls have a specified dollar amount limitation that they can place?
3. Does the supplier have an up-to-date list of individuals authorized to place calls and their respective dollar amount limitation?
4. Do receipts tendered show the following?
 - a. Supplier's Name
 - b. BPA number
 - c. Date of the call
 - d. Call number
 - e. Total list of items(s) or services furnished

- f. Quantities, unit prices, and discounts
 - g. Date of delivery or shipment
 - h. Name of individual placing call
5. Does the supplier submit at least a monthly summary of all deliveries?
 6. Does the BPA contain the supplement to the disputes clause IAW MCO P4200.15E, para 0674.17?

3. Purchase Orders

1. Is the PRD completely filled out?
2. Can the purchase be accomplished by utilizing the PO method only?
3. Are quotations for purchases in excess of \$500.00 annotated on the back of the PRD?
4. Are purchase orders filled out properly and IAW MCO P4200.15E, para 0651.3?
5. Are written solicitations prepared when:
 - a. Suppliers are outside of the local area?
 - b. Special specifications are involved?
 - c. A large number of items are in a single proposal?
 - d. Oral quotations are not considered economical or possible?
6. Are the required clauses included in the PO to cover the following?
 - a. Unpriced orders?

- b. Variations in quantity due to unit of issue or bulk quantities?
- c. All periodical subscriptions?
- d. When supplies are ordered on other than F.O.B. destination basis?
- e. For the humane slaughter of livestock?
- f. As directed by the Commandant of the Marine Corps (Code LE) ?

4. Delivery Orders

- 1. Is the PRD completely filled out?
- 2. Are delivery orders filled out properly and IAW MCO P4200.15E, para 0651.3?
- 3. Are individuals designated in writing to sign as the Ordering Officer?

H. ESTABLISHING THE SYSTEM TO BE IMPLEMENTED

The responsibility of an adequate system of internal control rests upon the Purchasing Officer. Therefore, the system to be implemented must be designed to fit his particular needs at the unit. The abilities of pertinent personnel, the requirements and needs of the unit, and the availability of the sources of supply all impact on the type of purchasing that must be performed by the unit. Though not necessarily an accurate forecast, historical data can be

invaluable when ascertaining the strengths and weaknesses in the current purchasing process. Utilization of the aforementioned development methodology section could reveal potential problems or weed out unnecessary trivia. But in the end, there is no absolute system of internal controls, and the Purchasing Officer must determine where benefits stop and excessive costs begin.

IV. IMPLEMENTATION AND MAINTENANCE METHODOLOGY

A. IMPLEMENTATION METHODOLOGY

The ability to successfully implement a system of internal controls (or changes therein) will greatly depend upon the amount of resistance to change encountered. Resistance to change can be overt (deliberate resistance) or covert (resistance due to other factors) [Ref. 14: P. 378]. Though deliberate resistance can be identified and dealt with as appropriate, covert resistance is much harder to identify and eliminate. An example of covert resistance is functional fixation.

Psychologists have found that there appears to be "functional fixation" in most human behavior in which the person attaches a meaning to a title or object and is unable to see alternative meanings or uses [Ref. 15: P. 194].

In short, the individual consciously or subconsciously does not recognize the change due to his past experiences and personal definitions.

To overcome resistance to change, the Purchasing Officer must carefully shape change implementation to fully institute needed internal controls. For this reason, this author suggests using the three phase change process of "unfreezing, change, and refreezing" [Ref. 14: P. 380].

The first two phases can be accomplished through an education and training session given to all participating personnel. The "unfreezing" is showing the need for change. This entails an explanation of how the controls will affect decision-making, the processing of purchase transactions, the directive requirements from higher headquarters, and any current identifiable shortcomings in the current purchase procedures. "Change" is then accomplished through a detailed explanation of the new procedures and controls. The full intent of each control should also be explained to emphasize the importance of the changes.

The final phase of "refreezing" is accomplished through the use of cognitive dissonance.

Cognitive dissonance can be seen as an antecedent condition which leads to activity oriented toward dissonance reduction just as hunger leads to activity oriented toward hunger reduction [Ref. 16: P. 3].

Active supervision will act as a cognitive dissonance vehicle through the follow-ups that confirm compliance with newly instituted controls. Subordinates not wishing to be confronted with non-compliance by the Purchasing Officer will strive toward close attention to the system of internal controls.

Active supervision will do more than just communicate the requirements established by the Purchasing Officer. If effectively utilized, "newly acquired behavior becomes

permanent, thereby offsetting the regression toward the old pattern of behavior after the pressures toward change are relaxed" [Ref. 14: P. 377].

B. MAINTENANCE METHODOLOGY

Active supervision also works as a method of maintaining the status quo compliance once the patterns of behavior have become permanent. However, the totality of the purchasing process and environment are not static and changes will occur. Be it the participating personnel, sources of supply, higher headquarter's directives, or the type of support required, changes are inevitable.

In the continuous strive for reasonable assurance that the system of internal controls is adequate, constant internal review is required. (MCO P7000.33 requires an internal control review at least biennially.) MCO P7000.88 has conceptualized the review into four general steps, which are as follows:

1. Define internal control objectives and parameters.
2. Develop internal control documentation.
3. Analyze existing internal controls.
4. Correct deficiencies in existing internal controls.

The new aspect of evaluation and correction of weaknesses in the existing system of internal controls has been brought

out as a integral part of the internal review process. Though all of the aforementioned thesis information still applies, new questions should be raised during this review process. Part of internal review is the ability to look in retrospect and make assumptions on the present by evaluating the past. Therefore, much of the direction of the questions needed for this evaluation are based upon the results of the performance, and not the development of performance standards for desired results.

A comprehensive listing of sample questions for the review process can only be developed by the individual responsible for judging the existing system of internal controls. However, some prospective questions dealing in general with the controls as specified in the previous chapter are as follows:

1. Purchasing Request Document

- a. Are item(s) and/or services requested part of the funded budget?
- b. Were exceptions to the aforementioned question high enough in priority to warrant a reprioritization?
- c. Is UMMIPS being properly utilized?
- d. Are cost estimations reasonably accurate?
- e. Are requests handled in a timely fashion?
- f. Are requests being split to fulfill actual needs?
- g. Are short notice delivery dates actually required?
- h. Was the item(s) and/or services received sufficient to fulfill the needs?

2. Source of Supply

- a. Is the normal supply source being utilized?
- b. Is there a valid reason for circumventing the proper source?
- c. Have the sources of supply changed?

3. Purchasing Methods

- a. Is the proper purchase method being utilized?
- b. Is there a valid reason for circumventing the proper purchasing method?
- c. Are purchasing method limitations being adhered to?

In some cases, using units have already established formalized systems of internal controls, necessitating the use of the MCO 97000.88 four generalized review steps from the start. In any case, internal review is always required because what works today may fail tomorrow.

V. SUMMARY AND CONCLUSIONS

A. SUMMARY

After a brief discussion of systems of internal controls and the effect of an inadequate system, the objective of administrative controls was revealed as the main direction of this thesis.

The beginning statements for the Requirements of an Adequate System of Internal Controls explored three aspects that impact upon the heuristics of system development. The rest of the chapter was a summarization of development requirements, techniques and implementation and maintenance requirements that can be utilized by the Purchasing Officer when developing his own system of internal controls.

In Chapter III, the presentation was the generalized administrative controls, with the major emphasis on the PRD as the central control document. The flow-charts were developed to facilitate the decisions made on the where and how for each purchase in a simplified format.

The final chapter was an attempt to explain the need for a plan to implement and maintain a system of internal control. Major points of consideration should be given to the internal review process and the resistance to change.

B. CONCLUSION

The rebirth in the concern for curbing fraud, waste, and abuse has had a great impact on DOD. With this resurgence has come renewed interest in adequate systems of internal controls. However, the traditional controls of "HOW" something is done has been joined with "WHY" something is done.

The intent of this thesis was to concentrate on administrative controls for the day-to-day operations. The quoted recent GAO Report specified that procedure manuals or regulations had not been incorporated into day-to-day operations. In order to facilitate the accomplishment of this objective, the proposed controls were kept simple and require little (if any) additional work to accomplish. (Because of this simplistic design, it is suggested that all proposed controls be utilized.) However, if proper adherence to the controls is maintained, sufficient information to make viable and practical decisions should be possible.

The generalized design is far from complete. Mandatory requirements are well specified in MCO P4200.15E, and this author felt that further accounting control development would not only be an unnecessary form of plagiarizing, but would belittle the needed impact of administrative controls. Additionally, further accounting control development would be too restrictive to the Purchasing Officer's authority and

responsibility of tailoring his control system to his particular needs. But, with Chapter II and the applicable orders, he should have sufficient explanatory information to complete a system suited to his situation while fulfilling all mandatory requirements.

There is no substitute for reading and understanding the appropriate manuals and directives. However, applicable controls that help limit and focus upon the appropriate references not only save time, but facilitate the strive for an adequate system of internal controls.

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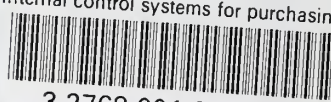
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